

State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Monthly Meeting October 28, 2009

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, October 28, 2009. The Treasurer called the meeting to order at 9:01 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici, Mr. John Treat, and General Treasurer Frank T. Caprio. Mr. Andrew Reilly arrived at 9:06 a. m. Also present were Mr. Stephen Geanacopoulos, of Adler, Pollock, and Sheehan and Mr. David Ursillo, of Rodio & Ursillo, Legal Counsel to the Commission; Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultants to the Commission; Mr. Nick Katsikis and Vin DeBaggis of State Street Corporation; Ms. Michelle Davidson of PCG, and Mr. Mark Dingley and other members of the Treasurer's staff. Ms. Rosemary Booth Gallogly, Dr. Robert McKenna, Ms. Marcia Reback were not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of September 23, 2009. Mr. Costello moved, Mr. Giudici and Mr. Treat seconded, and the subsequent motion passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici,

Mr. John Treat, and General Treasurer Frank T. Caprio

VOTED: To approve the Minutes of the September 23, 2009 monthly meeting.

General Treasurer Caprio reviewed the agenda then introduced Mr. Burns of PCA.

General Consultant Report. Mr. Burns indicated that members have a copy of the Real Return Investment Policy Statement for their records. This statement was approved at the September 23, 2009 meeting with these changes: A correction on the amount in TIPS now reads 0 to 40% per Ms. Booth Gallogly's request and the inclusion of a transitional benchmark that Mr. Costello suggested.

Mr. Burns reviewed the Opportunistic Portfolio Investment Policy Statement noting the material in this document incorporates the commission members views that have been discussed at prior meetings. The policy calls for a 5% allocation, which would be the alpha generator that can be held anywhere in the portfolio. It is designed to find cyclically high return investments or it could be a risk reducer in a unique instance.

Mr. Costello asked as we continue to add more asset classes and look at our overall benchmark at what point do we need a more static benchmark to measure the success or failure of our asset allocation decisions.

Mr. Burns clarified that there is a band of 1% on either side and these

individual investments are all going to have benchmarks. The over all benchmark needs to have a return of 8.25% to meet the long-term policy benchmark.

Treasurer Caprio observed that the Opportunistic Portfolio Investment Policy is a tool that will be available but does not require immediate implementation. He asked the board if there were any additional questions for Mr. Burns.

Treasurer Caprio entertained a motion to approve the Opportunistic Portfolio Investment Policy Statement as presented by Mr. Burns of PCA.

Mr. Giudici moved, and Mr. Costello and Mr. Treat seconded, and the subsequent motion passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio

VOTED: To approve the Opportunistic Portfolio Investment Policy Statement as presented on October 28, 2009.

Legal Counsel Report. Legal Counsel had no report.

General Treasurer Caprio then introduced Mr. Izzo and Mr. Marr, members of the Treasury staff.

Mr. Izzo stated Treasury manages \$1.8M to 2M in the Touro Synagogue Fund under the Commission's authority as designated in a bequest to the synagogue. Mr. Marr will cover the request of the synagogue representative.

Mr. Marr commented that the original donation of \$5,000 has been managed by the state for some time. The synagogue currently draws 4.5% per year. It is appropriately invested in a Fidelity Balanced Mutual Fund. Their concern is they are invested in one fund only and would prefer to diversify money managers since this represents a major part of their operating funds. We are in agreement with the request and ask the board to carry the following motion. To diversify the holdings of the Touro fund to mitigate institutional risk. To invest the funds in a way consistent with the Fund's need to withdraw the statutorily mandated 4.5% per annum. To maintain the general asset allocation strategy of investing in "Balanced" Mutual Funds where the asset allocation is approximately 60% Equities, 40% Fixed Income.

Treasurer Caprio asked for clarification on the fund as this is the first time some board members have addressed this fund.

Mr. Marr explained the fund was created in a bequest designating the state as the custodian to invest according to the prudent man theory. This is part of the General Laws 39.5-1. There was an amendment in the 1990s to codify the way the draw down is facilitated.

Mr. Treat asked if the Rhode Island Foundation would qualify as a manager.

Treasurer Caprio requested legal counsel look into the question raised by Mr. Treat.

Mr. Izzo stated the treasurer of the synagogue relayed the importance of this fund to their continued operation and strongly urges the approval of this motion.

Treasurer Caprio entertained a motion to adopt the language presented by Mr. Marr.

Mr. Treat moved, Mr. Gaudreau seconded, and the subsequent motion passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio

VOTED: To diversify the holdings of the Touro Fund to mitigate institutional risk. To invest the funds in a way consistent with the Fund's need to withdraw the statutorily mandated 4.5% per anum. To maintain the general asset allocation strategy of investing in "Balanced" Mutual Funds where the asset allocation is approximately 60% Equities, 40% Fixed Income.

Treasurer Caprio told the board there are two State Street matters to be addressed next. He asked Mr. Dingley to present the issue of the contract extension.

Mr. Dingley informed the board that we are requesting an extension of the current custodial contract with State Street for 2 months while negotiations are conducted for a renewal contract.

Treasurer Caprio entertained a motion that was made by Mr. Costello to extend the State Street Contract for 2 months under the existing terms and was seconded by Mr. Reilly. The subsequent motion

passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio

VOTED: To extend the State Street contract under the same terms for two months.

Treasurer Caprio advised the group that he and the treasury staff had been following a matter involving transactions made by State Street on behalf of two California pension funds, and therefore he requested a presentation by State Street to the SIC. He introduced Mr. Vincent DeBaggis of State Street.

Mr. DeBaggis provided the group with a written statement. He said State Street is disappointed that the Attorney General has moved on a whistleblower's claim surrounding foreign exchange services for 2 California pension funds. State Street denies any wrongdoing and spent 18 months providing information on the claim. He noted it was the Attorney General and not the pension funds that brought the action. The market in question is open 24 hours a day five days a week where prices move every second. State Street acts as a principal not an agent in the foreign exchange market like many other dealers. State Street is directed in writing for these services.

Mr. Goodreau requested a clarification for the group of the difference between a principal and an agent relationship. He also asked if Rhode Island has ever acted with State Street on an agent basis.

Mr. DeBaggis explained that State Street acts as an Agent as your

custodian to provide services at your direction. A Principal means State Street takes a position and acts as counter party to the fund.

Mr. Costello inquired if our legal counsel has reviewed our position.

Mr. Dingley commented that he had reviewed the complaint and spoke with our consultant Alan Emkin who is out in California. Mr. Emkin said that there was some concern regarding the level of communication between the Attorney General and the California pension funds.

Treasurer Caprio commented that we are interested in additional information as the case progresses and want State Street to provide correspondence or presentations on new developments.

Mr. DeBaggis reported updated information is available through their web site for staff and managers.

Treasurer Caprio requested the board's consideration in moving the November meeting date from the day before Thanksgiving to the preceding Wednesday, November, 18, 2009.

A motion that was made by Mr. Reilly to move the November meeting to November 18, 2009 and was seconded by Mr. Giudici. The subsequent motion passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio

VOTED: To move the November meeting date to November 18, 2009.

Treasurer Caprio called on Mr. Burns to start the dialog on the

subject of commodities.

Mr. Burns asked the members to reference the hand out Commodities – Policy Issues. He noted this is a long term strategic allocation as a potential inflation hedge. The goal is broad based or beta exposure with a return of 7 or 8% every year. We will look for products that are cost effective, have moderate liquidity and transparency without long lockups and without leverage. There are several vehicles and a variety of instruments that are appropriate.

Mr. Goodreau asked if we limit the types of instruments we permit will that also limit the managers we can use.

Mr. Burns replied it could limit managers.

He continued by covering the source of return, the styles of management available, commodity indexes, market headline risk and management strategies.

Treasurer Caprio called on Mr. Goodreau to introduce the PIMCO representatives.

Mr. Goodreau stated we have discussed the class in general resulting with board approval of the asset class in September. It is time to gain more specific information; therefore we called on PIMCO because of our longstanding relationship. He called on Bob Greer and Melody Rollins of PIMCO to make their presentation.

Ms. Rollins stated that Mr. Greer was the first to define an investable commodity index and is a leading expert in the area.

Mr. Greer asked the group to open the handout, a Fundamental Briefing on Commodities. This class is historically a good diversifier and a hedge against inflation. He discussed what drives the returns to

a commodities investment.

Mr. Costello asked if there is any type of investors that should not invest in commodities.

Mr. Greer stated just like any other asset you do not put more into it than you can afford to lose. As it relates to Rhode Island, a small investment will make a difference and should be comfortable.

Treasurer Caprio asked Mr. Greer's opinion of the notion in main street media that this type of investing can drive up pricing in certain classes.

Mr. Greer made clear he believes investors do not drive demand in the market place because they do not buy, hoard, store or consume the commodity.

He continued with a description of the different styles of managers. He gave an explanation of futures, swaps and notes.

Mr. Costello asked which method the larger funds use.

Mr. Greer stated most are swaps, but some are futures.

Mr. Treat asked about the risks posed by the counter party.

Mr. Greer stated the risk is the amount owing. If the party becomes insolvent it is unlikely payment will be made. A posting of collateral will buffer this outcome.

Treasurer Caprio asked why commodities move with the rest of the market (last year).

Mr. Greer stated the recession affected the demand for commodities followed by a global financial crisis further driving down prices. He continued with benchmarks the board might consider in the future.

Mr. Costello asked if the funds track the indexes well.

Mr. Greer replied they do especially those that use T-bills as collateral.

Treasurer Caprio thanked Bob Greer of PIMCO and called on Michele Davidson of PCG.

Ms. Davidson commented that valuations are stabilizing in private equity; they were trending down in the past few quarters given the decline in the public markets. In the second quarter we see valuations come up a bit. However, fully realized opportunities (including secondary sale) have provided a 19% net return since inception and 2.0x investment multiple.

Mr. Costello asked if the ratings in the report are based on numbers as of December or the fiscal year end.

Ms. Davidson replied the ratings are in the audited financials as of December 31. We will change ratings quarterly where necessary.

Mr. Costello asked if the base was fluctuating or an absolute rate of return.

Ms. Davidson replied the base depends on the age of the fund, the j curve, relative to its peer group, relative performance, how much capital has been deployed, and a number of other factors.

Treasurer Caprio stated that Ken and he met with Christopher Bower, the Chairman and CEO of PCG, to discuss our relationship with PCG and some issues we need to address. He noted Rhode Island has the one of their longest client relationships with 14 years.

Chief Investment Officer Report Mr. Goodreau thanked Mr. Burns for all the work he has done which has resulted in simplifying our program. Performance for the fund in the current month was up about

3%, although we are still seeing some lag from real estate. We are beating our benchmark by 69 basis point excluding private equity and real estate. The total plan is up almost 14% for the year.

Treasurer's Report. Treasurer Caprio thanked Bob Greer and Melody Rollins of PIMCO and the group for their consideration of the commodities presentation. He noted that Mr. Costello has vast experience in this area and thanked him for his insight.

He stated he is pleased that we are exceeding our benchmark. Our simplified program is paying off. Our philosophy on security lending has proved to be prudent seeing that California recently lost \$700 million in their plan and we exited ours with a \$10 million profit during the past year.

The Treasurer and CIO were recently asked to make a presentation to the Chinese Investment Corporation. It is an investment pool of \$200 billion that the Chinese government has put together. They were interested in our board structure and staff and how we look at products and costs of those products. They also met with the Harvard endowment.

New Business. There was no new business.

There being no new business, the Treasurer entertained a motion to adjourn. Mr. Treat moved, Mr. Giudici seconded and the subsequent motion passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Robert Giudici, Mr. Andrew Reilly,

Mr. John Treat, and General Treasurer Frank T. Caprio

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:41AM.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**